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MASS MARKETING TAX SCHEMES  
AND SELF-ASSESSMENT:  
SHIFTING THE GOAL POSTS?

Centre for Tax System Integrity

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### **Abstract**

Assessment is the process by which taxation liability is established. A system of self-assessment of taxation returns for individual taxpayers was introduced in Australia in the late 1980s, replacing the system of checking and assessment which was formerly undertaken by the Australian Taxation Office (Tax Office). Under self-assessment taxpayers became legally responsible for getting their tax returns right, but recent statements suggest that some taxpayers may not understand this added responsibility. In fact, it appears that a significant number are unaware that the method of making their assessment had actually changed. According to Murphy and Bing (2002) 58% of survey respondents indicated that the receipt of a tax assessment notice indicated to them that the Tax Office has checked and approved their taxation returns. Taxpayers who erroneously believe the Tax Office still checks their returns might assume that deduction claims not disputed by the Tax Office were actually approved. Imagined approval could encourage a taxpayer to make similar claims in subsequent years, whether or not those deductions were legal, and even if that taxpayer had a commitment to acting in compliance with the tax laws. This misunderstanding about self-assessment presents a serious issue for taxpayer compliance generally, and for the integrity of the taxation system as a whole.

## **Mass Marketed Tax Schemes and Self-assessment: Shifting the Goal Posts?**

*Centre for Tax System Integrity*<sup>1</sup>

### ***Background***

Artificial tax minimisation schemes have been around for many years. Generally they are used by wealthy and aggressive taxpayers and are dealt with by the Tax Office on an individual basis. The growth of so called mass-marketed schemes during the 1990s meant they came to represent a large scale problem for the Tax Office. Investment in the schemes started growing in the early 90s, and was first noted by the Tax Office in late 1994.<sup>2</sup> In 1997 the Tax Office released a draft taxation ruling indicating that the schemes were tax avoidance arrangements, and that scheme related tax deductions would be disallowed.<sup>3</sup> The Tax Office followed up with several high profile court cases attacking the schemes. Other initiatives, such as the Product Rulings system, were also introduced. Investment in the schemes peaked in 1998, and subsequently declined.<sup>4</sup>

The investors' returns were amended to disallow their scheme related deductions, penalties were imposed for getting the returns wrong, and interest was charged from the date of the original assessment. Many investors complained that the Tax Office had changed the rules retrospectively, or had 'shifted the goal posts during the game'. While there was a lag between people making their investments and lodging their returns, and the Tax Office announcing it would disallow deductions, the schemes were found to be ineffective under law applicable at the time the investments were made. As no

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<sup>1</sup> In particular, we wish to thank the following people for their contribution and critical analysis of the ideas presented in this paper: John Braithwaite, Kersty Hobson, Tina Murphy and Rob Williams.

<sup>2</sup> The first meeting to decide on a coordinated response to schemes was held in Canberra in October of that year.

<sup>3</sup> Draft Taxation Ruling TR 97/D17 specifically addressed afforestation schemes but the opinion that the financing arrangements were artificial, and the associated expenses not deductible, applied equally to other types of schemes.

law was changed, and there was certainly no back-dating of any change, by definition there was no retrospective action on the part of the Tax Office. The investors' statements suggest that a reasonable number of them were unaware that the Tax Office had wide powers to examine, and if necessary amend, their returns after they had received their assessment notice.

Collectively these findings suggest that a significant number of investors had failed to grasp two of the most basic platforms of self-assessment. First, that the Tax Office issues assessment notices without checking the information supplied by taxpayers, and second, that it has the power to check returns and amend assessments at a later date. It is probable that these misconceptions apply equally in the broader taxpaying community, especially for those who have never had a tax return amended by the Tax Office. In fact, Murphy and Byng (2002) found that scheme investors were significantly better educated than the general population, but then this does not necessarily translate into sophistication as far as taxation is concerned. The rather basic errors about self-assessment do not augur well for the ordinary taxpayer's understanding of the more subtle and difficult issues involved in calculating their tax liability, such as their knowledge and understanding of a lengthy and complex body of taxation law, Tax Office rulings, and court decisions.

As Braithwaite (2003) points out, compliance with any type of regulation requires that citizens understand what behaviour is required of them. These requirements must be communicated in a way that they can be understood, and acted upon. Hobson (2004a) suggests that self-assessment "requires individuals to be wholly responsible for practices and knowledge over which they have little control or access". Hers is one of several recent papers which outline the challenges and difficulties presented by self-assessment (see also Mumford 2002, D'Ascenzo and Poulakis 2002, Dirkis and Payne-Mulcahy 2002, The

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<sup>4</sup> Senate Economics References Committee (2002)

Australian Ombudsman 2001, Senate Economics References Committee 2002). Other writers have also argued that there is a social contract between taxpayer and the Tax Office where responsibilities and obligations are not written down in law or administrative procedures, but are part of the taxpaying culture (see Braithwaite 2003, Rawlings 2003). These authors argue that unwritten expectations also have a profound effect on taxpayers' behaviour. This may be so but it is not the basis for the analysis provided here. This paper takes a more legalistic approach to understanding the tax contract.

The investors' protests about the perceived backdating of decisions, and the perceived tardiness of the Tax Office's response, came to the attention of the Australian Tax Ombudsman, and the Senate Estimates Committee. Both agencies issued reports<sup>5</sup> which were broadly supportive of the Tax Office's actions but which also acknowledged the length of time taken to respond. Both urged that concessions be granted to investors.

The Tax Office did extend considerable concessions for those schemes which it determined did not involve sophisticated investors. The concessions were in the form of allowing deductions for actual expenses incurred<sup>6</sup> (ie that portion of the investment which was not created by artificial financing arrangements), as well as reductions in the levels of interest and penalty that were imposed. While investors did not receive the 'wiping of the slate' they were seeking they ended up with a significantly lower tax burden than was originally calculated. The lower amount of liability negotiated by investor groups, along with the previously outlined misunderstandings about how the system operates, demonstrates the difficulties with self-assessment. This system was designed to put responsibility in the hands of taxpayers, but this responsibility has been misunderstood by some, and denied by others.

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<sup>5</sup> The Australian Ombudsman (2001), Senate Economics References Committee (2002).

<sup>6</sup> Where a scheme is found to be a sham, normally no deduction would be allowed.



This research explores the self-assessment paradox by examining responses to the *Australian Tax System Survey of Tax Scheme Investors (The Investor Survey)*, which was undertaken by the Centre for Tax System Integrity at the Australian National University. The method of collecting and analysing the investor's statements will be set out first, a summary of the responses will then be presented, and finally some conclusions will be drawn. As some of the respondents to the survey had participated in the tax protests it has been suggested that responses might also have been politically motivated. Again this could be so, but an extremely high level of coordination and deliberate misstatement would have been required to account for all 58% of those respondents who indicated the basic misconception about the tax system. The true proportion of taxpayers who have these misconceptions may not be knowable from the data examined here, but anything above zero would be cause for concern given the Tax Office's Tax Charter commitment to helping taxpayers understand their taxation obligations.

The responses to *The Investor Survey* have been reported at face value without judgment to the truth or otherwise of the statements, and no attempt has been made to determine the motivation behind them. Themes of unfairness and retrospectivity come through strongly in the statements, as do themes of the tax system being too complex, disappointment and anger at the lack of responsibility placed on tax advisers, and the Tax Office having too much power. The way that self-assessment compromises the security of taxpayers is a common thread to the statements. Collectively the responses provide the investor's side of the mass marketed schemes issue but, perhaps more importantly, they also provide an insight into taxpayers' experience of the self-assessment system, and the capacity of the broader population to meet their obligations under this system.

### ***Research Method***

The data for this paper were collected as part of the *Investor Survey* (Murphy and Byng 2002). The *Investor Survey* was sent to 6,000 scheme investors who were selected at random from the Tax Office schemes database. For privacy reasons the questionnaires were addressed and mailed by the Tax Office, and the anonymous responses were sent to the ANU for analysis. At the time of conducting the analysis for this paper 2029 people had responded to the survey. A further 272 responses were subsequently received, but these came too late to be included in the present analysis.

The survey contained mainly quantitative questions but five open-ended questions were also asked, and an invitation to provide additional comments was made at the end of the document. The quantitative responses to the survey will be analysed in other papers, and the responses to the open questions are of primary interest here. The open questions asked here provided a rich source of data, with some answers running to a page or more. One of the open questions was particularly pertinent to the experience of self-assessment, and this will be examined in detail. This question was:

- Do you believe the Tax Office's request for you to amend your return is reasonable? If not, why not?

Comments added at the end of the survey expanded on this point and accordingly they have been included in the analysis. NVivo qualitative analysis software<sup>7</sup> was used to analyse the comments, and to provide a count of the issues seen of highest importance to investors. Quotes are added to illustrate the themes that emerged. Note that the surveys were returned prior to the

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<sup>7</sup> QSR International Pty Ltd 1998-2001

completion of two court test cases decided in favour of the Tax Office, so they reflect the views of taxpayers who were still disputing their tax liabilities.

### *Summary of Responses*

Question: Do you believe the Tax Office's request for you to amend your return is reasonable? If not, why not?

This was also a quantitative question in the survey and Murphy and Byng (2002) report that 85% of respondents said the amendments were unreasonable. The most frequently stated reasons for the 'unreasonableness' can be grouped under four broad themes:

1. The Tax Office gave the scheme explicit or implicit approval, and then changed its mind.
2. The investor acted in good faith or thought the business/claim was genuine.
3. The Tax Office view was inconsistent with advice received from tax agents.
4. The tax system is too complicated and/or unfair.

These themes are expanded upon below. The figures shown represent the proportion of survey respondents who gave each particular reason (n = 2029). Note that many answers were complex and many contained more than one reason. Note also that 15.7% of respondents did not provide any qualitative answer to this question.

1. The Tax Office gave explicit or implicit approval of the schemes

This group was easily the largest of the four, with 51.5% of responses indicating that the Tax Office had somehow approved the schemes, or had failed to demonstrate that they were not approved.<sup>8</sup>

Tax Office acted retrospectively (16.3%)

Tax Office was too slow to act (9.8%)

Tax Office action was a change or reversal of an existing position (8.7%)

Receipt of assessment taken as approval of claims (7.2%)

Tax Office inaction taken as implicit approval (3.7%)

Tax Office had made a 'ruling' on the issue (3.6%)

Tax Office did not initially have a problem with the scheme (1.3%)

Tax instalment deduction variations<sup>9</sup> were taken as approval (0.9%)

The most common response within this category was that the Tax Office had acted retrospectively (16.3% of responses). Retrospectivity is placed in this broad category because, for the Tax Office's action to represent a retrospective change, the investors must first have thought their scheme had been approved. The following statements illustrate this theme. One said: "4 years passed and each return was accepted. They made use of their ability to change their rules and then retrospectively re-assess me." One respondent likened this to changing the road rules: "if you were fined \$100 for doing 80kph in a 70kph zone in 1996, then fined a further \$100 ... because the speed limit in that area is now 60kph ... would you pay?" It is possible that retrospectivity is mentioned frequently because it is widely considered to be an unacceptable action for government administrators. If the Tax Office had acted retrospectively there would be genuine cause for grievance. While there was not a retrospective action in a technical sense taxpayers or their agents are still required to apply

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<sup>8</sup> This does not exactly correspond with 51.5% of respondents as some provided more than one answer. This also applies to the other categories.

<sup>9</sup> These variations allow people to have less tax deducted from their regular income, on the assumption that a lower amount of overall tax will be payable at the end of that year.

tax legislation to the facts of their case at the time their return is lodged, and this can be well in advance of the law being clarified. It is a subtle point and it is perhaps understandable that some taxpayers saw the Tax Office's actions as being backdated. 1.1% of these respondents used the exact term 'shifting the goal posts' when describing the Tax Office's actions.

A further 8.7% stated that the Tax Office had reversed an existing policy position but did not specifically mention retrospectivity. As cited previously, Murphy and Byng (2002) found that 58% of respondents had indicated that receiving a tax assessment (usually accompanied by a refund cheque) meant their deduction claims had been approved. The following statements are representative of this finding: "the Tax Office had approved similar claims for at least 2-3 years giving me the impression that the claim is legal". "If the return was not valid at the time it should not have been approved". "My assessment was originally approved by the Tax Office. That should be the end of it". Many of the respondents indicated a very different understanding of 'approved' than that of the Tax Office. The responses suggest that they thought, or at least hoped, that the receipt of their tax refund meant the Tax Office had checked and approved the deduction claims. D'Ascenzo and Poulakis (2002) suggest this misunderstanding may be partly due to terminology. The word 'assessment' is a carry over from the previous system and implies that some sort of checking and verification has been carried out.<sup>10</sup> They suggest using the term 'statement of account' to indicate the more passive role of the Tax Office in the current assessment process.

To reduce their uncertainty taxpayers can ask the Tax Office to make a private binding 'ruling'. These set out how the Tax Office will apply a particular aspect of the law, and 3.6% of responses claim that the Tax Office had made a positive

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<sup>10</sup> Arithmetic is checked and addition errors corrected.

ruling on their scheme.<sup>11</sup> The Tax Office did issue positive rulings on some early schemes - such as controlling interest super and employee benefit arrangements - before the full implications of these arrangements became clear. Even so, such rulings are still binding on the Tax Office provided the scheme arrangements were implemented in accordance with the facts spelt out in the ruling application. If they are not the ruling can be withdrawn and the investors will lose the protection provided by the ruling.<sup>12</sup>

It has been reported that some promoters showed private rulings obtained by other taxpayers to potential investors to convince them the schemes were legitimate. As private rulings provide protection only to those taxpayers who apply for them, existing rulings would have no effect for new investors. People were misled by promoters if they thought they could rely on these rulings: "some people had private rulings to say [the scheme was] OK". Only a few investors actually applied for private rulings, and it seems others were not encouraged to do so. This may be because their advisers did not want them to alert the Tax Office to the existence of the scheme, or that they were led to believe the law was already settled and clear, or perhaps they did not know that this avenue was open to them. Others claim they did apply but without success: "waiting nearly two years for a private ruling by the Tax Office is crap, in the Charter it states I will be treated fairly - what a joke".

It is possible that some respondent's statements referred to product rulings which are rulings that apply to all the investors in a scheme. These were a late development and were unlikely to have impacted on a significant number of respondents. Again there is a requirement that the arrangement be implemented in the way spelled out in the product ruling application. In a few

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<sup>11</sup> The word 'ruling' is used fairly loosely by the respondents - sometimes it applies to official Tax Office rulings, and at other times to verbal or written opinions.

<sup>12</sup> *Bellinz Pty Ltd & Ors v FCT*

cases the promoters obtained a product ruling but then implemented the financing arrangements in such a way as to make that ruling ineffective. Taxpayers who act on product rulings in these circumstances will not receive protection from reassessment. This means the Tax Office can seek redress from the investor even though it was the promoter that has acted inappropriately. Whatever the cause, 3.6% of respondents expressed the view that the Tax Office had made a ruling and later reversed it: "they changed their opinion about a previous ruling and are retrospectively taxing us". "A tax ruling was changed and then retrospectively applied, resulting in the amendment. We can only work within the rules and expect them to be honoured." Some expressed the view that rulings were unreliable and could be changed at the whim of the Tax Office.

Other forms of implied approval described by the respondents were: the acceptance of tax instalment deduction variation applications by the Tax Office, and the Tax Office's 'silence' on whether schemes were acceptable or not. Apparently investors assumed, or gambled, that the apparent lack of action meant that the schemes were acceptable to the Tax Office. This is consistent with a belief that the returns had been checked and approved. It was widely stated that if the Tax Office had a problem with the schemes it should have said or done something about it. Nevertheless, only 1.3% of respondents reported that checking directly with the Tax Office about whether it 'had a problem' with the schemes was the major cause of their concern. 9.8% of responses indicated that the Tax Office had acted too slowly, and this was the second highest overall response. The following comment was typical: "the request relates to my 1995/1996 tax returns. Why wait 6 years?" Some interpreted the Tax Office's 'silence' as tacit approval: "they did not act in a timely manner. This resulted in my considering the claim was valid". "If they had acted sooner after my initial investment I would not have invested again".

Tied to the suggestions that the Tax Office was too slow, or had not made its opinion known, is an assumption that the Tax Office actually knew about the schemes in question. D'Ascenzo and Poulakis (2002) report an apparent expectation among taxpayers that the Tax Office knows about all products in the market place, and has formed opinions about those products. They point out that the Tax Office does not have the capacity to achieve this, and instead uses a risk assessment methodology to identify where to direct its resources. The assumption that the Tax Office knew about the scheme and would act promptly if it had a problem may be part of the unwritten tax contract discussed by Braithwaite (2003) and Rawlings (2003). As the Tax Office is not resourced to meet this expectation taxpayers might have to learn to expect less from the Tax Office. They need to understand that unless they receive a binding ruling they cannot assume their deduction claims are effectively 'approved' until the period for amendment of their assessment has lapsed. This period is 2 years for individuals with simple tax affairs and 4 years for others. The period for amendment is extended to 6 years if the Tax Office determines that tax avoidance is involved, as happened with the mass marketed scheme investors.

While the speed of the Tax Office's response was widely criticised by respondents, the Commissioner did amend the returns within the six years allowable under the *Income Tax Assessment Act*. If the Tax Office acted within the correct time frame but in a way that was considered unfair it may be the law allowing amendment over six years that the respondents have judged to be unfair. D'Ascenzo and Poulakis (2002) report that the amendment period for taxpayers with simple returns has been reduced to two years to provide them with greater certainty although this would only provide comfort to taxpayers who actually knew they were in that category. Dirakis and Payne-Mulcahy (2002) argue this policy should be extended to all individual taxpayers.

## 2. Invested in good faith/thought business or claim was genuine



This was the second most common theme expressed by respondents.

Claim is legitimate (6.7%)

Invested in good faith (6.6%)

Individual intentions not considered (suggesting intentions were honest) (6.2%)

Business is viable (3.2%)

Matter is still in dispute (2.9%)

25.6% of respondents claimed that the deduction claims were legitimate or were made in good faith. The following response was typical for those who perhaps felt they were acting honestly: "they have not assessed me as an individual. They don't know my reasons for investing. ... I have been lumped with other more aggressive tax planners." On the other hand there may be some who had doubts about the scheme's legitimacy but who thought that nothing would be done about it: "I did all that could be asked of me to ensure that I was within the current guidelines at the time." Some pointed out that the matter was still in dispute suggesting that they had not accepted the Tax Office's view and felt strongly enough to contest their case in court.

6.2% of responses mentioned that their individual intentions were not taken into consideration. There are three important aspects to this. One is that the purpose of the investors will dictate the way they feel they should be treated. If they believed their intentions were genuine they would feel more slighted if they were treated by the Tax Office as being tax avoiders. The second is that the levels of administrative penalty applied by the Tax Office vary with apparent intention - lower levels of penalty apply for tax 'shortfalls' considered to be due to negligence or recklessness, while higher penalties apply for shortfalls considered to be deliberate. The final aspect is that intention or purpose is important for determining whether the general anti-avoidance provisions (Part IVA) of the Tax Act will apply to the scheme. Having a purpose of minimising

tax is acceptable provided the dominant purpose is something else, such as earning income in retirement. If gaining the tax benefit is deemed the dominant purpose the scheme will be struck down with significant penalties added. Concern about this provision may account for the frequency that respondents mention intention as they may have believed that their good intentions would protect them from penalty. This hope was misplaced because the court determines purpose on the basis of objective facts, and not subjective psychological factors.

In fact, the subjective purpose of the investor may be irrelevant practice. For instance, in the case of *Vincent vs Federal Commissioner of Taxation*, it was determined by Justice French that Ms Vincent had acted in good faith, but the scheme was still struck down. French found that there was a difference between the form of the arrangement as advertised to investors, and its substance as implemented.<sup>13</sup> It was ruled that the promoter had the dominant purpose of providing a tax benefit and that this was sufficient for Part IVA to apply. Presumably these facts were not transparent to the taxpayer at the time, suggesting that she needed to both evaluate the investment as it was presented to her and to anticipate the promoter's future actions. The Tax Commissioner has stated that if something "appears to be too good to be true it usually is",<sup>14</sup> and this should alert taxpayers to the artificiality of the scheme. However, as Hobson points out, a lay person is making this judgement. Justice French's finding that obtaining the tax benefit was not the primary purpose of Ms Vincent suggests a disjunction between the lay person's conception of good faith and intention as subjective and personal to them, and the law's more objective conception of inferring the purpose from the facts of the case. There is

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<sup>13</sup> Specifically, loans between related entities controlled by the promoter were not made as stated in the prospectus. *Vincent vs Commissioner of Taxation* [2002] FCA 656 (24 May 2002).

<sup>14</sup> Commissioner of Taxation (2001) *Taxation: Current Issues and Future Directions*. Speech to the Australian Institute of Company Directors, Perth. 1 May 2001

a technical shifting of the lay person's goal posts of intention and this subtlety may be lost on some taxpayers.

3. Acted on professional advice which was later found to be inconsistent with the Tax Office view

Nearly 80% of individual taxpayers pay an accountant or tax agent to complete their returns for them. In fact, so few complete their own returns that the term self-assessment may be a misnomer. The uncertain relationship between taxpayers and tax agents is the focus of the responses reported here.

Acted on professional advice (8.7%)

Victim of fraud or greed (1.0%)

The most common response from investors in this category was they had acted on professional advice. This view has several facets. For most it appears that the adviser had convinced them that the investments were legitimate and that they trusted their adviser's opinion: "all professional advice I received at the time of investing was that the investments were legal and legitimate deductions". "I acted on the advice of a professional adviser who had worked in the industry all his life". They appeared confused when the Tax Office's view did not accord with their adviser's view. Others thought that they had done their bit to establish deductibility whether they thought the scheme was legitimate or not: "I sought the advice of three separate financial advisers all licensed and registered. I sought the advice of a taxation accountant and I visited the Tax Office to discuss my plans prior to investing. Without exception I was encouraged to proceed. I believe this demonstrates due diligence on my part." For others it was that they were deliberately misled: "I was the innocent victim of fraud."

Evidence from other studies shows that their advisers mediate the behaviour of taxpayers. For instance, Sakurai and Braithwaite (2001) suggest that aggressive investors seek out aggressive agents who will minimise their tax, while more law abiding investors can be persuaded to invest by trusted advisers. Braithwaite (2001) found that conservative advisers lost their risk-taking clients when they were not prepared to put them into aggressive arrangements. Many of the investors also consulted financial advisers - some of whom received incentives to get investors into schemes - and others dealt directly with the scheme promoters themselves. Current regulations address the activities of tax agents but other financial advisers and promoters are largely unregulated. Tax Office examinations of the schemes offered during the 1990s showed schemes ranged from genuine investments, through sham arrangements designed to minimise tax, right up to fraud on the investor. This demonstrates that promoters and advisers had their own agendas when dealing with investors. It is apparent that the various advisers had exerted an influence on some taxpayers' decisions of whether to invest or not, and many did not have the best interests of the investor at heart. The Australian Securities and Investment Commission recently published a report suggesting that many financial advisers continued to act in their own interests.<sup>15</sup>

Several respondents felt it was unfair that they should be targets of Tax Office action when it was the agent who had acted inappropriately: "I should not be penalised for acting on bogus investment advice". A few respondents were aware that advisers could be sued for negligence [S251 (M)1 of the *Income Tax Assessment Act*] but they generally reported that it was too expensive to pursue. Given the limited chance of success mounting a legal challenge against a firm of well-resourced experts was seen as throwing good money after bad. D'Ascenzo and Poulakis (2002) report that legal action to recover taxes from agents is an

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<sup>15</sup> Australian Securities and Investment Commission (2003) Compliance with advise and disclosure obligations: ASIC report on primary production schemes.

avenue only rarely pursued by taxpayers, and as such has had little effect on improving the behaviour of marginal tax agents. This suggests it is an ineffective deterrent for agents who consider acting against the best interests of their clients. Perhaps tax preparers would be less willing to recommend aggressive tax planning if there were associated preparer penalties as there are in some other tax jurisdictions.

Cutting across the responses in this category is a questioning of the role of tax agents and advisers in the self-assessment system. The respondents seemed under the impression that acting on their tax agent's advice might offer them some protection from amendment, and several criticised the lack of responsibility placed on agents and advisers: "if you are going to have a self-assessment system, then the taxpayer relies on information from advisers, lawyers, tax agents etc." "Financial advice through a credited company should not require analysis by an individual." Under the common law rules of agency the actions of the tax agent are equated to those of the client, and generally speaking the client is held responsible for any liability incurred by the agent on their behalf. Nevertheless, a number of respondents questioned why they were held responsible for complex advice given to them by tax professionals, as this means they have to be confident the advice they are being given is correct. It was pointed out that if they understood the tax laws to this degree they would not need to consult an expert in the first place.

#### 4. Tax system is too complicated and/or unfair

Broadly speaking the residual responses are complaints about the way the tax system or the Tax Office has impacted negatively on the respondents (the concepts of tax system and Tax Office were intertwined and apparently indistinguishable to some respondents). These responses represent less than 10% of all responses and come under a large number of sub-headings. Themes which represent less than 0.5% of all responses have not been reported.

Tax Office was negligent or incompetent (1.6%)

System is inequitable or unjust (1.5%)

Reversal/delay was a Tax Office plot to increase revenue (1.4%)

Tax Office bullies investors (1.4%)

Tax Office decisions are not objective (ie are designed to protect the revenue)  
(0.7%)

Tax system is too complicated or inadequate (0.7%)

Tax Office should go after promoters (0.6%)

Tax Office should protect investors (0.6%)

A small group of respondents stated that they were disadvantaged by the system and that the wealthy receive preferential treatment from the Tax Office: “the Tax Office have attacked only the small investor. This is simply because we are a soft target unable to afford the legal defence to protect ourselves from this injustice.” The Tax Office position is that the law does not discriminate against different types of taxpayers but on occasions the risk assessment method of administration makes this difficult to avoid. For instance, tax schemes were not treated as a major risk to revenue until salary and wage earners became involved, and deductions reached high levels. Braithwaite, Pittelkow and Williams (2001) suggest that the more effective tax planners get into new arrangements quickly, reap the benefits and get out, leaving the slower adopters to be picked off. More than one respondent suggested that the Tax Office acted on schemes not because they were illegitimate, but because too many people were using them: “the Tax Office appears to be driven by overall revenue concerns rather than strict administration of the law.” One questioned why their scheme was amended while others used by wealthier taxpayers were not: “many similar projects such as infrastructure [bonds] have not had their deductions amended retrospectively”.

Two elements of a good tax system are fairness and certainty, and some respondents suggested that these areas required improvement: “the Tax Department (sic) seems to change their rulings without consideration of the individual taxpayer. What may be a legal deduction today may not be a few years later”. Some respondents said that the law is open to interpretation, and that this makes it possible to put in a return that is correct as far as the taxpayer or tax agent is concerned, but which will eventually be deemed incorrect by the Tax Office. They pointed out the difficulty of self-assessment under these circumstances. Some stated that they had requested assistance but it was not forthcoming: “at the time of entering a tax minimisation scheme the Tax Department would not give opinions on the legality of the scheme and we had to rely on the promoter’s advice”. Others stated the Tax Office should analyse the schemes when they are first released as this would serve to protect investors.<sup>16</sup> Again there is the assumption that the Tax Office knew about the schemes in question.

While some of the responses under this heading suggested that the Tax Office were negligent or incompetent, a few claimed that the Tax Office’s slow reaction to schemes was a deliberate plot to raise revenue: “they knew it would not be allowed; yet passed it. Then six months later called me a tax cheat.” The issue of complexity was again raised and a few suggested it was a shield the Tax Office can hide behind: “the Tax Office is using the complexity of the Tax Act to its own advantage - rejecting allowable deductions when the advice I’ve obtained from 2 experts says they are allowable”. Perhaps some investors believed that the lack of Tax Office action meant the investments were without risk, or that they could act without consequence, and this may account for some of the anger expressed: “the Tax Office’s actions were two faced, cannot be

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<sup>16</sup> Investor protection is one of the responsibilities of the Australian Securities and Investment Commission. Strictly speaking, the Tax Office’s area of responsibility is revenue protection. However, there is some overlap between these roles and Tax Offices ‘product rulings’ and ‘taxpayer alerts’ now address investor protection issues to some extent.

trusted, vindictive, not fair, autocratic, immoral, not accountable, inconsistent". Then again, their tax advisers should be able to explain the requirements of the system to their clients, assuming they were inclined to do so. Some stated the Tax Office had chosen the wrong target: "people like me were duped. The people they should be chasing are the dupers not the dupees". Some in this group were particularly aggrieved that they were first defrauded by advisers and promoters and then later penalised by the Tax Office.

#### Summary for Question 1.

85% of respondents reported that the Tax Office's decision to amend their tax returns was unreasonable. Over 50% of responses stated that the Tax Office had somehow indicated the schemes were acceptable or had failed to indicate otherwise. Some interpreted this as reversing an existing policy. Around 25% of responses suggested that they had invested in good faith while 10% emphasised the role of their advisers in their decision to invest. A further 10% indicated the system was too difficult or unfair, while 15% did not provide an answer.<sup>17</sup> Few respondents accepted that they themselves might have been responsible for their situation although a very small percentage reported feelings of shame about being involved in schemes. What this suggests is a lack of understanding of the obligations of the self-assessment system among many scheme investors, and that their advisers had not been particularly helpful in alleviating their ignorance. Many investors appeared surprised to find that the Tax Office no longer checked their returns and approved their deductions and they seemed to miss the certainty and security that this action provided.

#### *Additional Comments: Is there anything you would like to add?*

781 respondents (38.5%) added further comments at the end of their surveys. The open structure to this question allowed respondents to address issues that

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<sup>17</sup> Note that these amounts will not sum to 100%, due to some respondents providing more than one answer.



were of most overall importance to them regardless of context, or to address issues that had not been touched on by other questions in the survey. Frequency of response is again expressed as a percentage of total number of survey respondents (n = 2029). Some responses ran to several pages.

The themes revealed in the added statements were, in order of frequency:

Taxpayers do not know enough to self assess/self regulate (10.8%)

Tax Office has too much power/cannot be trusted to use power appropriately (7.2%)

Tax system unfair or inadequate (5.0%)

Respondents identified themselves as honest/hard-working (4.2%)

Tax system too complex and agents should shoulder greater responsibility (3.7%)

Tax Office is incompetent (3.7%)

Negative effects on family (2.9%)

Lack of access to procedural justice (2.9%)

Tax Office failed in Taxpayers' Charter responsibilities (2.5%)

Tax Office too slow to act (2.4%)

Invested in good faith (2.4%)

Tax system does not treat taxpayers equally (2.1%)

The major themes found here are similar to those already described with an additional themes of the Tax Office having too much power, and another describing of the negative effects the episode had on the respondent's family.<sup>18</sup>

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<sup>18</sup> It is perhaps worth noting that the bulk of responses to the other open questions in the survey concerned the negative effects of the episode on the respondents' family and relationships, on their finances, on their physical, mental and emotional health, and their reduction in trust of government, the Tax Office, financial advisers, and investments.

One respondent expressed the frustration of many when he said: “last year I paid my accountant \$7000 to do my tax accounts, yet it is I who will be responsible if any mistakes are made. Considering the complexity of tax law, this is a ridiculous situation!!” A common view was that one of two things should happen to make the self-assessment system more accessible - either the system should be made simpler and more certain so they can prepare returns themselves, or else more responsibility should lie with the advisers they pay to do their returns. “This self-assessment policy is ... open to abuse. It puts the taxpayer in a position where he needs the wisdom of Solomon when doing his tax. We have tax accountants and lawyers whose profession is the tax system and even they are unable to always agree on what is right or wrong. Yet if the tax payer is not able to read the mind of the Tax Office he is prosecuted as a tax avoider, as has happened in my case.”

Certainty of the law and knowledge of the law appear to be major issues for taxpayers under the self-assessment system. One respondent said the following: “my accountant advises that even if you get Tax Office approval for an action [it] can be reversed at any time - in other words Tax Office advice is not dependable or reliable - you sink or swim as best you can.” One put it succinctly: “most Taxation Officers are uncertain about tax laws, but ordinary people [are] expected to know it all!” Others noted that they did their best to comply under the circumstances but still came up short: “I believe that I took all the necessary steps and precautions in checking the bona fide’s of the financial adviser, the company and that there was a market for the product (tea tree oil) that the average person would be expected to do”. One respondent placed the complexity in a broader context: “I find the tax system bewildering and full of traps for the non expert. The ambiguity is a goldmine for the legal profession and huge waste of the country’s resources. There is a large migration of intellectuals from the knowledge enhancing professions to the financial industry.”

A perceived inequity in the system was also mentioned: “the tax system is too complicated for the average resident to be confident that they are getting a fair deal. Under this system people who can buy expertise will always pay less than others.” It appears that some of the respondent’s frustration was due to a perception that wealthier taxpayers receive preferential tax treatment. A common lament was that the tax system made it hard for the ‘ordinary working man’ to get ahead: “I have always paid large amounts of tax with very few deductions. ... I find it distressing to read that millionaires can achieve taxable incomes of \$20K or less.” A few respondents suggested ways of ‘improving’ the tax system. A novel suggestion was to offer lower tax rates for people who had paid certain threshold amounts of tax over their lifetimes as a reward for being good citizens. The more common suggestion involved a flat rate of tax of either 10% or 20% and the complete removal of tax deductions. While this would produce the obvious outcome of less tax being payable by many taxpayers it is perhaps no coincidence that it would also remove the perceived preferential treatment afforded to the wealthy. One pointed out that wealthier taxpayers could not pay their accountants to find loopholes when no loopholes existed. Ironically, this proposal would also mean the end of taxation schemes of the type used by the respondents. Other respondents thought the tax system needs to be overhauled, and a small number rejected the need for taxation altogether.

Another theme to emerge was that the Tax Office has too much power, or could not be trusted to use its power appropriately. This incorporated themes such as the Tax Office failed in its obligations under the Taxpayers’ Charter, and in providing access to procedural justice:

“the Tax Office is too powerful - it currently makes tax law, administers tax law/collects tax & presides over/prosecutes/determines tax issues; separation of administrative & law enforcement roles required; Tax

ombudsman role ineffectual - it bends to the will of the Tax Office/powerless to influence Tax Office."

Another responded this way: "people like me feel, despite their wealth and education, at the mercy of either greedy and dishonest accountants/legal practitioners or dogmatic, biased and uncooperative Tax Officers. We need a simpler and fairer tax system".

Having an identity as an 'honest' or 'hard working' taxpayer was mentioned by 4.2% of respondents. In addition, approximately 100 respondents questioned the tone of *The Investor Survey* as they thought it contained an implication that they had deliberately minimised their taxes. It is likely that these people would also identify themselves as honest and hard working. Several respondents complained about being "lumped with other more aggressive tax planners", and not having their individual intentions taken into consideration. Under the Taxpayers' Charter people are supposed to be treated as individuals but the large number of people involved in tax schemes made this administratively difficult for the Tax Office to achieve. One respondent said: "the Taxpayers Charter should be torn up. The Tax Office ignores it!" Another respondent made this complaint: "I have not had replies to 2 letters I have written the Tax Office even though I specifically requested a response (13 months have elapsed). 2 responses did not even remotely address the questions I had asked in my correspondence." The perception that they were not treated as individuals meant that some respondents felt they were treated as 'tax cheats' whether they deserved it or not.<sup>19</sup> "The Tax Office needs to treat people like me with some respect not as if I were a criminal." The difficulty in determining which taxpayers were innocent victims and which were only portraying

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<sup>19</sup> A common theme was indignation at being labelled a 'tax cheat'. As far as can be determined the Tax Office never made this accusation. Investors apparently drew this conclusion after receiving letters from the Tax Office which stated it would seek to apply the legislation which deals with artificial tax avoidance schemes (Part IVA).

themselves as such made the individual treatment of the investors problematic for the Tax Office.

### *Conclusion*

Self-assessment was introduced in the 1980s with the idea that it would make taxpayers responsible for getting their tax return right, but it seems that some taxpayers have not fully grasped that additional responsibility. To be able to properly self-assess taxpayers need a clear understanding of what the Tax Office requires of them and this involves interpretation of a long and complex body of tax law, court cases, and Tax Office rulings. This may be asking a lot from taxpayers who have little knowledge or training in the field. Some felt these added responsibilities were unfair. The way that their security was compromised by self-assessment was a common theme. It may be that taxpayers have not been adequately educated about the functioning of self-assessment, or understanding it may be beyond their capacity of some. If people can be properly educated about the system it might reduce the level of non-compliance caused by ignorance, and perhaps reduce the excuses made by others to justify their behaviour, but this would not solve the more systemic problems. While not advocating a return to the old system, the responses suggest that some adjustments are required.

The study revealed four major misconceptions or problems in the way that some taxpayers understood the self-assessment system. The first and most important is that they think their deductions are checked before an assessment is issued when no formal checking process exists. 58% of respondents got this wrong, and this may well understate the level of ignorance in the broader population who have not had a return recently amended by the Taxation Office. The second is a lack of knowledge about the Tax Office's power to amend returns after issue and the period of time over which this can be done. The third misconception is that acting on the advice of accountants will somehow offer

security and protection to the taxpayer. The fourth area is broader and concerns the rulings system. Investors did not apply for rulings when they should have, and this may be due to ignorance about rulings. On the other hand, some claim they applied for rulings but allegedly did not receive them, and others claimed to have acted on rulings and were not protected anyway.

The facts necessary to dispel the first two misconceptions can already be found in Tax Office publications, such as the Tax Pack.<sup>20</sup> However, there is so much detail contained in this publication that people can overlook the main issues. Further, only 20% of taxpayers actually use Tax Pack and the 80% who consult a tax agent will not receive exposure to its contents (unless their tax agent volunteers the required information to them). The Tax Ombudsman report suggested that as all taxpayers (should) receive an assessment notice this would provide an appropriate medium for passing on the necessary facts about self-assessment. While some important information is already provided on the assessment notice there is plenty of room for elaboration. For instance, record keeping requirements are mentioned but it is not explained that records must be retained because a review and amendment of the assessment is possible and that this can take up to six years under certain circumstances. Then again facts alone may be insufficient to achieve the desired outcome here, and it may be necessary to tell stories to illuminate the issues in a way that the lay person can understand. Whatever method is employed the mass marketed schemes situation illustrates how important it for the integrity of the system that these misconceptions be overcome.

But it could be that education alone is insufficient to solve all these problems. Respondents emphasise that all parties have added responsibilities under self-assessment. For instance, certainty of law and certainty in administration are

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<sup>20</sup> This publication is provided to those individual taxpayers who prepare their own returns.

prerequisites for self-assessment to work, and the Tax Office has a responsibility to ensure that this is provided. Some respondents found this lacking. One respondent put this view very strongly:

“Under self-assessment there is a much greater obligation on both Government and the Tax Office. The Government’s obligation is to simplify the tax act so that ordinary people can understand it. This it fails to do. The Tax Office has an obligation to be very clear about its interpretation of this law and it must do this prospectively. This it has failed miserably to do. The Tax Office has got itself into the problem of tax effective schemes primarily because it has failed to clearly determine its position and to communicate this with the taxpaying public and the accounting and tax industry. Rather it finds it easier to deal with a problem by decree and retrospective decisions followed by penalties rather than getting ahead of the game”.

Mumford (2002, p119) suggests that “whilst increasing complexity of tax law is never a good thing, it is less defensible in a system of self-assessment, accompanied as it is by harsher penalties for a taxpayer now expected to operate this legislation directly”. Mumford argues that self-assessment has actually facilitated the growth of complexity in legislation by removing law drafters from the practical day to day interpretation and administration of tax laws. She suggests that writers of tax laws are not concerned about adding complexity when deciphering the meaning of those laws is going to be left to other people. The suggestion of respondents that many deductions be done away with would dramatically simplify the tax system. While this would add certainty and security, as well as reduce the responsibility and workloads of all parties involved, the solution is unlikely to be embraced by the professions given the substantial effect it would have on fees generated from tax advice.

It is a strange paradox that taxpayers are expected to check the correctness of advice they receive from agents when the reason they consult the agent is precisely because they do not understand tax laws in the first place. Respondents suggest that if the system cannot be simplified and more certainty provided the imbalance can be rectified by increasing the responsibility which rests with tax agents and other advisers in the financial system. It seems unlikely that any major simplification can be achieved, given the growth of the *Income Tax Assessment Act* over the last 15 years, and a number of brave attempts to simply it.<sup>21</sup> That said, additional responsibility is unlikely to be embraced by the professions either, and Dirkis and Payne-Mulcahy (2002) claim that keeping up with changing tax laws is even beyond some accounting firms. The Tax Office also gets its interpretation wrong sometimes with roughly a significant number of appeal decisions going against it (Tran-Nam and Blissenden, 2000). It seems that while the experts can struggle with the complexity of the system the responsibility for getting returns right has been taken from the Tax Office and the professions and moved to the people least equipped to do the job.

As it is currently structured the tax system does seem to be balanced against the taxpayer. If the taxpayer acts on incorrect or misleading advice from their agent or other financial intermediary the Tax Office has only to amend his return and add penalties. The taxpayer then has to incur the additional expense of suing the adviser to get their money back. As taxpayers very rarely sue their advisers this sanction has had no real deterrent effect on the activities of unscrupulous tax agents, financial advisers, or scheme promoters. In other jurisdictions advisers face direct legal sanction for failing to act in the interests of the taxpayer. The Tax Office has been asked to prepare a submission to address this deficiency and these recommendations may provide effective

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<sup>21</sup> From 450 pages in 1986, to 8500 in 2002. (Kohler 2002)



disincentives to negligent or borderline actions. Even if effective sanctions were implemented it could be argued that taxpayers should also have access to some sort of consumer protection against poor or misleading advice, similar to what the Trade Practices Act provides in relation to the supply of retail goods. Whatever the ultimate course of action might be, until some way of restoring and the security of taxpayers can be found, the Tax Office will be susceptible to accusations of goal post shifting.

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